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Getting Health Savings Accounts Right

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The growing success of Health Savings Accounts (HSAs) is a policy victory, but Congress should be cautious not to overstep the role of the government in the health insurance marketplace. Policymakers eager to build on the success of HSAs should focus on improving the management and administration of these arrangements, but resist tempting efforts to manipulate the market in favor of them. Congress should retain a level playing field for free market competition in health insurance, including HSAs.

The Progress of the HSA

Health Savings Accounts were enacted as part of the Medicare Modernization Act of 2003 and allow individuals who have a HSA-qualified high-deductible health plan to set aside funds in a tax-preferred account to pay for qualified health care expenses, including the deductible. The value of this arrangement is that it gives individuals a new low-premium health insurance and pre-tax savings option—an affordable alternative to traditional high-premium, first-dollar coverage.

HSAs build on the original Medical Savings Accounts (MSAs) concept but remove many of the regulatory obstacles Congress imposed on MSAs. Among those changes, Congress removed the cap on the number of MSA-style policies that could be sold, eliminated the sunset provisions on the accounts, and allowed both employers and employees to make contributions. By undoing many burdensome regulations, the creation of HSAs was a tremendous policy victory and leveled the playing field for HSA arrangements in the health insurance marketplace.

Thus far, the data are encouraging. According to an America's Health Insurance Plans (AHIP) survey, over 3 million people were covered by an HSA-qualified high-deductible health plan as of January of this year.[1] The report also estimates that 31 percent of HSA-qualified policies sold in the individual market were purchased by individuals who were previously uninsured. In the small group market, 33 percent of businesses who have HSA-qualified high-deductible policies previously did not offer coverage to their workers.[2]

A more recent analysis by eHealthInsurance, a national online health insurance broker, found that 45 percent of individuals purchasing a HSA-qualified high-deductible plan earned less than $50,000 a year.[3] Both studies also found that HSA policies were purchased by all age groups.[4]

This paper, in its entirety, can be found at:
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New Policy Initiatives

In this year's budget, President Bush proposed a variety of HSA-specific policies, from technical administrative changes to more significant changes aimed at improving and expanding the adoption of HSAs. Members of Congress have been quick to introduce legislation embodying these policies. H.R 5262, the "Tax Free Health Savings Act of 2006," introduced by Representative Eric Cantor (R-VA), is the most comprehensive legislation and incorporates most of the HSA proposals made by the Administration. Some proposals included in the bill are worthy of consideration, but others are problematic.

The Right Way: Administrative Improvements

H.R. 5262 includes a variety of positive and useful provisions that take into account the past three years of experience with HSAs and would improve the administration of HSA arrangements:

- Allow individuals who purchase a HSA-qualified high-deductible health plan to pay their premiums from the HSA;
- Increase the maximum contribution limit to an HSA to match total out-of-pocket expenses, not just the deductible;
- Permit employers to vary contributions for chronically ill workers; and
- Establish greater compatibility between HSAs and other health account arrangements, such as flexible spending accounts (FSAs) and health reimbursement accounts (HRAs).[5]

The Wrong Way: Titling the Marketplace

The problematic provisions of H.R. 5262 would establish new tax preferences in favor of high-deductible health plans. The Bush Administration proposal and the Cantor bill both rightly aim to create greater tax equity between those who obtain coverage of their own, without any tax preferences, and those who obtain coverage through the tax-preferred employer-based system. Both proposals would provide tax relief to those who purchase coverage on their own but only to those who purchase a HSA-qualified high-deductible health plan. They would accomplish this by making two changes to the tax code:

- Extend an above-the-line tax deduction for the premium of an HSA-qualified high-deductible health plan, and
- Offer a refundable health care tax credit for the purchase of a HSA-qualified high-deductible health plan.

While efforts to provide tax relief to those who purchase coverage on their own, outside the place of work, is a worthy goal, limiting such tax relief to HSA-qualified high-deductible health plans perpetuates the manipulation of the tax code in favor of certain health insurance arrangements, limits individual choice, and is incompatible with tax simplification.

Moreover, H.R. 5262 increases the tax penalty on non-qualified withdraws from an HSA from the customary 15 percent, which applies to most tax preferred accounts (such as IRAs), to 30 percent. It also applies a 15 percent tax penalty on non-medical withdraws by the disabled, Medicare enrollees, and heirs—populations that were specifically excluded from such penalties in the original law.

A Better Approach: Government Neutrality

Instead of adding to the already complex patchwork of federal health care tax subsidies, Congress should make H.R. 5262's tax relief provisions simpler and more equitable by expanding their application to all health insurance products. The above-the-line deduction and tax credit should be capped at a certain dollar amount so that *individuals* could choose the health care arrangement that best suits their individual needs, which could include, among others, a high-deductible, low-premium HSA option.

For the tax deduction, an individual who chooses a policy with a premium above the cap would be able to deduct only up to the specified capped amount. And those who qualify for the tax credit could choose a policy with a premium above the credit's cap but would be responsible for paying any premium balances above the credit.[6] This approach would give individuals the freedom to choose the plan design that best reflects their personal health preferences, would encourage prudent plan selection, and most importantly, would promote tax equity.

Congress should consider eliminating the high-deductible health plan requirement for HSAs altogether and allowing individuals to use their HSAs as a savings mechanism for all health care expenses, including premiums, deductibles, and other cost-sharing requirements.[7] A free-standing HSA could also be a conduit for employer contributions as well as other subsidies, such as a health care tax credit. The Heritage Foundation has long proposed replacing the existing patchwork of health care tax preferences with a universal health care tax credit.[8]

Conclusion

The true success of Health Savings Accounts can be tested only in a fair and equitable marketplace in which consumer choice—not the government—determines winners and losers. Congress should be cautious when considering policy initiatives that tilt the market in favor of a specific product, even if that product is an economically rational choice. Instead, Congress should look for other ways to promote market-based health care coverage while remaining neutral to an individual's personal health care choices.

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1 America's Health Insurance Plans, Center for Policy and Research, "January 2006 Census Shows 3.2 Million People Covered by HSA Plans," March 3, 2006, at www.ahipresearch.org/pdfs/HSAHDHPReportJanuary2006.pdf.

2 *Ibid*.

3 eHealthInsurance, "Health Savings Accounts: January 2005-December 2005," May 10, 2006, p. 9 at image.ehealthinsurance.com/content/ReportNew/2005HSAFullYearReport-05-10-06F.pdf.

4 America's Health Insurance Plans, p. 4, and eHealthInsurance, p. 8.

5 For a full description of these provisions, see Nina Owcharenko, "Building on the President's Health Care Agenda," Heritage Foundation *Backgrounder* No. 1934, May 11, 2006, at www.heritage.org/Research/HealthCare/bg1934.cfm.

6 Conversely, those who are eligible for the tax credit and who choose an HSA policy could deposit any remaining tax credit balance into the HSA.

7 Other prominent health care think tanks have recommended similar changes, see John C. Goodman, "Making HSAs Better," National Center for Policy Analysis *Brief Analysis* No. 510, June 30, 2005 at www.ncpa.org/pub/ba/ba518 and Michael F. Cannon, "Combining Tax Reform and Health Reform with Large HSAs," Cato Institute *Tax and Budget Bulletin* No. 23, at www.cato.org/pubs/tbb/tbb-0505-23.pdf.

8 See Stuart M. Butler, "Reforming the Tax Treatment of Health Care to Achieve Universal Coverage," in Economic and Social Research Institute, Covering America: Remedies for the Uninsured, Vol. 1, June 2001, at www.eresearch.org/RWJ11PDF/butler.pdf.